BEFORE

THE PUBLIC SERVICE COMMISSION OF

SOUTH CAROLINA

DOCKET NOS. 2002-367-C and 2002-408-C - ORDER NO. 2004-464

OCTOBER 5, 2004

IN RE:	Docket No. 2002-367-C – Generic Proceeding to Address Abuse of Market Position	)	ORDER DENYING REHEARING AND/OR RECONSIDERATION
	and	)	
	Docket No. 2002-408-C – Generic Proceeding to Address Inflation Based Index	)	

This matter comes before the Public Service Commission of South Carolina ("the Commission") as a result of a Petition for Rehearing and/or Reconsideration ("Petition") filed by the Acting Consumer Advocate for the State of South Carolina ("Consumer Advocate") in Docket Nos. 2002-367-C and 2002-408-C. We note that while the Consumer Advocate filed its Petition in both of these dockets, the issues raised by the Consumer Advocate's Petition do not address any matters we decided in Docket No. 2002-367-C. Accordingly, we find that the Consumer Advocate has not sought review of our decision in Docket No. 2002-367-C. With regard to Docket No. 2002-408-C, we address the issues raised by the Consumer Advocate's Petition and clarify our Order No. 2003-656 in the following review and discussion.

I. PURPORTED ERRORS OF LAW

The Consumer Advocate argues that “[b]y finding that South Carolina law does not provide for the use of a productivity factor, the Commission is ignoring the plain language of the statute." *See* Petition at p.2, ¶5. We disagree, and we clarify that we find that Section 58-9-576(B)(4) does not specifically require us to use a productivity factor. This statute provides that

> For those companies to which item (3) applies, after the expiration of the period set forth above, the rates for flat-rate local exchange residential and single-line business service provided by a LEC may be adjusted on an annual basis pursuant to an inflation-based index.

The statute does not direct us to establish a "cost-based index" or a "productivity-based index." Instead, the statute plainly and specifically requires the use of an "inflation-based index." We are persuaded by the testimony of Verizon witness Dr. Dennis Trimble that "inflation-based index" means "an index that is based on a measure of inflation" as opposed to an index that is based on a measure of costs, a measure of productivity, or a measure of some other factor. (Tr. at 275). We have also again reviewed the testimony of BellSouth witness Dr. William Taylor and are persuaded that "[i]n economics, an inflation-based index would be an index that begins at 100 (for example) at the beginning of the plan and changes each year by some measure of the change in U.S. output prices." (Tr. at 793). We clarify that we have adopted exactly such an index in this proceeding. The inflation-based index we adopt is based on the GDP chain-type index known as the GDP-PI. *See* Order at p. 10. For any given company, this index will begin at 100 and will be adjusted annually based on the change in the GDP-PI.

Our finding that Section 58-9-576(B)(4) does not require us to use a productivity factor is further based on a comparison of the language of this statute to the language of similar statutes in other jurisdictions. Florida statutes, for instance, provided that

> the local exchange telecommunications company may thereafter on 30 days' notice adjust its basic service revenues once in any 12-month period in an amount not to exceed the change in inflation less 1 percent.

See FLA. STAT. ANN. §364.051(3)(emphasis added).[1] This is similar in concept to the "inflation-based index less productivity factor" formula that the Consumer Advocate proposes. The difference, of course, is that the Florida statute clearly spells out an "inflation less 1 percent" formula in plain and unmistakable language. Section 58-9-576(B)(4), in contrast, clearly calls for the use of an inflation-based index without any mention of or reference to a productivity factor. This conclusion is further supported by language in Georgia and Tennessee statutes, both of which clearly distinguish between an inflation-based index and a productivity or other set-off factor.[2]

Under South Carolina law, "the construction of a statute by the agency charged with its administration will be accorded the most respectful consideration and will not be overruled absent compelling reason." *See Brown v. South Carolina Dep't of Health & Env. Control*, 348 S.C. 507, 515, 560 S.E.2d 410, 414 (2002). *Accord Nucor Steel v.*

[1] As explained below, this statute recently was amended. *See* 2003 Fla. Sess. Law Serv. Ch. 2003-32 (C.S.S.B. 654)(West).

[2] *See* GA. CODE ANN. §46-5-166(c)("Rates for basic local exchange services may be adjusted by the electing company subject to an inflation based cap. Inflation shall be measured by the change in the GDP-PI. The electing company is authorized to adjust the cap on an annual basis. The cap requires that the annual percentage rate increase for basic local exchange services shall not exceed the greater of one-half of the percentage change in the GDP-PI for the preceding year when the percentage change in the GDP-PI exceeds 3 percent or the GDP-PI minus 2 percentage points.")(emphasis added). *See also* TENN. CODE ANN. §65-5-209(e) ("A price regulation plan shall maintain affordable basic and non-basic rates by permitting a maximum annual adjustment that is capped at the lesser of one half (1/2) the percentage change in inflation for the United States using the gross domestic product-price index (GDP-PI) from the preceding year as the measure of inflation, or the GDP-PI from the preceding year minus two (2) percentage points.")(emphasis added).

South Carolina Public Serv. Comm'n, 310 S.C. 539, 543, 426 S.E.2d 319, 321 (1992)("Where an agency is charged with the execution of a statute, the agency's interpretation should not be overruled without cogent reason."). We are confident that our finding that Section 58-9-576(B)(4) does not require us to use a productivity factor is well-founded and correct. Accordingly, we decline the Consumer Advocate's request that we reconsider this finding.

II. OTHER PURPORTED ERRORS

In addition to finding that Section 58-9-575(B)(4) does not require us to use a productivity factor, we further found that economic policy does not necessitate the use of such a factor. *See* Order at 10. The Consumer Advocate challenges this finding on several gounds. We will address each of those challenges below.

A. Challenges to the Sufficiency of Our Findings

The Consumer Advocate claims that our Order contains “no findings of fact” supporting our decision not to use a productivity factor. *See* Petition at p.3, ¶6. According to the Consumer Advocate, our Order “recited testimony from witnesses for the Staff and local exchange companies that conflict with [the testimony of the Consumer Advocate’s witness], then simply states that [we believe] these witnesses offer ample reasons why the concept of a productivity factor should be rejected.” *Id.* Based on these assertions, the Consumer Advocate argues that our Order is “in violation of S.C. Code Ann. § 1-23-350 and *Able Communications v. S.C. Public Serv. Comm'n*, 290 S.C. 409, 351 S.E.2d 151 (1986)." We disagree.

In *Able*, the Supreme Court stated that "the findings of an administrative body must be sufficiently detailed to enable the reviewing court to determine whether the findings are supported by the evidence and whether the law has been properly applied to those findings." *Id.*, 290 S.C. at 411, 351 S.E.2d at 152. The Court stated that while "no particular format is required," a mere "recital of conflicting testimony followed by a general conclusion" is not sufficient. In subsequent decisions, the Supreme Court has explained that:

> *Able* holds that in order to comply with S.C. Code Ann. §1-23-350 (1986), the findings of fact of an administrative body must be sufficiently detailed to enable a reviewing court to determine whether the findings are supported by the evidence and whether the law has been properly applied to those findings. *Able* does not require any particular format for the findings of facts.

Hamm v. American Tel. & Tel. Co., 302 S.C. 210, 214, 394 S.E.2d 842, 844 (1990). *Accord*, *Vulcan Materials Co. v. Greenville County Bd. of Zoning Appeals*, 342 S.C. 480, 494, 536 S.E.2d 892, 899 (Ct. App. 2000)("Generally, the format of a final decision is immaterial as long as the substance of the decision is sufficiently detailed so as to allow a reviewing court to determine if the decision is supported by the facts of the case."); *Cloyd v. Mabry*, 295 S.C. 86, 367 S.E.2d 171 (Ct. App. 1988)("Findings of fact and conclusions of law need not be presented in any particular format. They need only be sufficiently detailed to enable a reviewing court to determine whether fact findings are supported by evidence and whether the law has been correctly applied.").

In the *Hamm* decision, the Supreme Court held that our Order modifying the frequency of the filing and format of surveillance reports complied with *Able*, explaining that

> Included in the Commission's findings and conclusions, was specifically

> that information contained in the surveillance reports could be market sensitive and that because it could be obtained by the public under the FOIA, the reports should be modified and streamlined in a manner as suggested by a staff witness. Although under the order's heading, "III. FINDINGS AND CONCLUSIONS," the Commission does not recite the underlying reasons for its conclusion in a regimented style, the underlying reasons are adequately set forth under the order's heading, "II. DISCUSSION." For example, the Commission's conclusion that information contained in surveillance reports could be market sensitive and should be modified and streamlined is overwhelmingly supported by the Commission's "discussion" of the testimony of various witnesses who stated that the information could be used to various IXC's disadvantage by their competitors who had access to the reports.

Hamm, 301 S.C. at 214-15, 349 S.E.2d at 844-45 (emphasis added). Similarly, in the subsequent decision of *Parsons v. Georgetown Steel*, 318 S.C. 63, 465 S.E.2d 366 (1995), the Supreme Court determined that a workers compensation commissioner's decision not to award psychiatric expenses to the claimant complied with the requirements of the *Able* decision. The Court explained that

> The commissioner provided the underlying facts in the order by summarizing Dr. Gagliano's medical testimony and opinion that [the Claimant] did not have a diagnostic condition needing psychiatric treatment that was attributable to his accidental injury. He stated in his Findings of Fact: "I find that Claimant has no emotional or psychiatric problem that is attributable to or the result of the compensable injury he sustained to his back on November 8, 1977, while working for the Employer." Accordingly, the commissioner concluded that the respondents were not liable for any medical expenses associated with Parsons' emotional or psychiatric problems.
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> The circuit court found that the Commissioner's order included "concise, explicit statements of fact, preceded by a summary of what he considered to be the important events and testimony supporting such Findings of Fact." We agree [citing the *Able* decision].

Id., 318 S.C. at 66, 456 S.E.2d at 368 (emphasis added).

Our Order states that "[b]ased on the reasoning and testimony" that we cited on pages 5 through 10 of the Order, we find that the GDP-PI "is the best index available for purposes of the statute" and that "the statute does not provide for use of a productivity factor nor does economic policy necessitate it." *See* Order at p. 10. We are confident, therefore, that our Order complies with the *Able* decision as applied by the Supreme Court in the *Hamm* and *Parson* decisions. In order to put the issue to rest, however, we will further address this matter.

We find that our decision not to use a productivity factor will not harm consumers.[3] This finding is based upon substantial evidence including, without limitation, BellSouth witness Dr. William Taylor's testimony that "[a]n inflation-based adjustment leaves *real* prices unchanged, i.e., consumers pay no more in inflation-adjusted terms than before (thus leaving their purchasing power unaffected) . . . ." (Tr. at 739). In addition, we find that the nominal price changes that would result from an inflation-based index without a productivity factor are not likely to seriously impact consumers. In support of this finding, we note that the highest price for BellSouth's flat-rate local exchange residential service today is $15.40 (in Rate Group 7). *See* BellSouth General Subscriber Service Tariff A3.2.1.A.2.a.(2). Since 1996, the greatest change in the chain-type GDP price deflators has been 3.13%, (*see* Composite Hearing Exhibit No. 1 – JES-3), and using that figure as an inflation-based index for a given year would result in an increase of less than fifty cents per month (from $15.40 to $15.88) – or less than $6.00 per year – for flat-rate residential service in the highest-priced residential rate

[3] Accordingly, we reject the Consumer Advocate's argument that our findings are "to the detriment of the overwhelming majority of telephone ratepayers in South Carolina" and that we have chosen "to adopt an anti-consumer interpretation of Section 58-9-576(B)(4)." *See* Petition at p. 2-3, ¶5.

group. A more representative change of 2% would produce an increase of less than twenty-five cents per month (from $15.40 to $15.71) -- or less than $3.00 per year – for flat-rate residential service in the highest-priced residential rate group. It is highly unlikely that such minimal rate increases will have a significant or detrimental impact on residential customers.[4] (*See* Tr. at 310).

We further find that using a productivity factor will harm consumers by continuing to deprive them of more vigorous competition for flat-rate local exchange residential service. This finding is based upon substantial evidence including, without limitation, BellSouth witness Dr. Taylor's testimony that the long-standing requirement that BellSouth and other ILECs price flat-rate local exchange residential service below incremental cost has contributed to the delayed onset of competition for flat-rate residential service on a stand-alone basis. (*See* Tr. at 748).[5] Further, Dr. Trimble testified that adopting a productivity factor likely would cause further reductions in these rates, and "[t]here never will be competition if these [services] continue to be priced below costs." (Tr. at 298). Finally, Dr. Taylor testified that maintaining prices for flat-rated residential services below incremental cost makes it "difficult—if not impossible—for potential entrants to seriously consider providing the service on a stand alone basis" and

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4 The impact on flat rate local exchange residential service for Verizon is similar. The highest rate is $16.13. *See* Verizon South General Customer Service Tariffs §3.2.1.a.(1) and 3.9.3.A.

5 Dr. Taylor testified that assuming constant nominal costs and an inflation rate of 2% per year, it would take 8 years before the price of flat-rate residential service in Columbia / St. Andrews actually covers the costs of the service. Dr. Taylor testified that it would take 23 years for this to occur in Florence, 27 years for it to occur in Summerville, 33 years for it to occur in Anderson, and 57 years for it to occur in Camden. (Tr. at 802-03). The factual basis for this testimony is set forth at pages 801 through 803 of the transcript.

that it induces new entrants "to either (1) only provide the service in conjunction with bundled offerings that include other services such vertical features and long distance services; or (2) provide other services (including multiple-line business local exchange service) for which more attractive margins are available." (Tr. at 748).

The Consumer Advocate's witnesses, Mr. Buckalew, recommends that we use a productivity factor because he "do[es] not believe that utilizing the CPI or GDP-Deflator without a productivity factor will adequately measure a telephone company's actual changes in costs to provide service in South Carolina." (Tr. at 194). This might be a valid point for companies that are operating under traditional rate of return or rate base monitoring regulation, because the rates that such companies may charge are based in large part on their costs of providing service. Section 58-9-576(B), however, plainly states that a company operating under that statute may elect to have the "rates terms, and conditions for its services determined pursuant to the plan described in this subsection, <u>in lieu of other forms of regulation including, but not limited to, rate of return or rate base monitoring or regulation</u> . . . "(emphasis added). Accordingly, Mr. Buckalew's concerns regarding the costs of providing service have no place in a proceeding under Section 58-9-576.

B. Arguments that Our Findings are Not Supported by the Evidence

The Consumer Advocate suggests that the evidence of record in this proceeding does not support our decisions in this matter. *See, e.g.,* Petition at pp. 3-4. We disagree. Our decisions must be supported by substantial evidence, and the Supreme Court has explained that

> Substantial evidence is relevant evidence that, considering the record as a whole, a reasonable mind would accept to support an administrative agency's action. Substantial evidence exists when, if the case were presented to a jury, the court would refuse to direct a verdict because the evidence raises questions of fact for the jury. It is more than a mere scintilla of evidence, but is something less than the weight of the evidence. Furthermore, the possibility of drawing two inconsistent conclusions from the evidence does not prevent a court from concluding that substantial evidence supports an administrative agency's finding.

See Porter v. South Carolina Pub. Serv. Comm'n, 333 S.C. 12, 20-21, 507 S.E.2d 328, 332 (1998). After a careful review of the record, we have determined that our decision is supported by substantial evidence.

1. FCC's Use of Productivity Factor

The Consumer Advocate argues that the testimony addressing the FCC's treatment of productivity factors (which we cite on pages 9 through 10 of our Order) is misleading. *See* Petition at pp. 3-5. We disagree. With the implementation of the FCC's Pricing Flexibility Orders and CALLS Order, the 6.5% "X factor" now only applies to certain transport and special access services.[6] BellSouth witness John Ruscilli testified that as a result, the majority of BellSouth's interstate revenues and services under price caps are no longer subject to the "X factor," (Tr. at 496), and the Consumer Advocate

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6 *See* Fifth Report and Order and Further Notice of Proposed Rulemaking in CC Docket Nos. 96-262, 94-1, CCB/CPD File No. 98-63, and CC Docket No. 98-157, *In the Matter of Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Interexchange Carrier Purchases of Switched Access Services Offered By Competitive Local Exchange Carriers, Petition of US West Communications, Inc. for Forbearance from Regulation as a Dominant Carrier in the Phoenix, Arizona MSA*, 14 FCC Rcd 14221 (1999)("Pricing Flexibility Order"); and Sixth Report and Order in CC Docket Nos. 96-262 and 94-1, Report and Order in CC Docket No. 99-249, Eleventh Report and Order in CC Docket No. 96-45, *In the Matter of Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Low-Volume Long-Distance Users, Federal-State Joint Board on Universal Service*, 15 FCC Rcd 12962 (2000)("CALLS Order"), ¶160**.**

presented no evidence to the contrary. Moreover, the FCC made it clear that the "X factor" it established in that Order is no longer based on any estimate of potential LEC productivity growth relative to the economy, but that instead, the "X factor" is an explicit device to reduce carrier access charges to prespecified levels by the end of the plan. The FCC's Order states:

> During the five-year term of the CALLS Proposal, the X-factor as adopted herein <u>will not be a productivity factor</u> as it has been in past price cap formulas. Instead, the X-factor is now a transitional mechanism to lower access charges to target rates for switched access, and to lower rates for a specified time period for special access. Although the X-factor under the CALLS Proposal <u>will not be tied to price cap LEC productivity</u>, it will lower access charges over the term of the proposal.[7]

Thus, as Staff witness Dr. Spearman testified, the “X factor” the FCC established in its CALLS Order "really is not a productivity factor." (Tr. at 165). It is clear, therefore, that the FCC currently is not using a productivity factor.

2. Activity in Other States

The Consumer Advocate argues that Dr. Trimble's testimony regarding the use of productivity factors in other states is misleading. *See* Petition at 4. We disagree. Dr Trimble testified that Verizon operates in 28 states and in the District of Columbia. (Tr. at 288). He further testified that

> In nine of these locations, [Verizon] operates under rate-of-return regulation. In 20 of those locations, it operates under an alternative form of regulation ("AFOR"). Ten of those locations have pricing formulas that are based on some measure of inflation (usually GDP-PI). Only six of those states still incorporate an inflation-based index and a productivity offset.

(Tr. at 288). The Consumer Advocates argues "[t]hat leaves four states that have some

7 CALLS Order, ¶160 (emphasis added).

form of inflation based alternative regulation without a productivity offset," that Dr. Trimble "did not provide for the record in this case where those four states are," and that he did not state whether "any of these states allowed basic local rates to increase simply by the rate of inflation." *See* Petition at 4. We note that the Consumer Advocate was afforded the opportunity to engage in written discovery with the parties of record. We further note that for whatever reason, the Consumer Advocate chose not to cross examine Dr. Trimble on the specific identity of the four states referenced in the Petition. The fact that Dr. Trimble did not specifically identify these states does not undermine his testimony, nor does it prevent the Commission from relying on Dr. Trimble's testimony that is based on his own personal knowledge and examination of actions taken in other states.

Moreover, Dr. Trimble's testimony is not the only evidence that other states have eliminated the use of productivity factors. BellSouth's witness Mr. Ruscilli testified that in establishing the Transition Regulation Plan for BellSouth in August 2000, the Kentucky Public Service Commission eliminated the productivity factor that had previously applied to non-competitive (basic) services under a price regulation plan initially instituted in July 1995. [8] He also testified that in revising BellSouth's Price Regulation Evaluation Plan in October 2001, the Mississippi Public Service Commission eliminated the requirement that BellSouth reduce its basic service revenues annually by

[8] Order, *In the Matter of Review of BellSouth Telecommunications, Inc.'s Price Regulation Plan,* Docket No. 99-434 (Kentucky Public Service Commission, August 3, 2000).

1% or $3.75 million, whichever was greater, as instituted initially in January 1996.[9] Moreover, as BellSouth noted in its brief, the Florida Legislature enacted a statute by which BellSouth's basic services would no longer be subject to the formula GDP-PI minus 1%, but instead, would be treated the same as non-basic services, where price changes are not subject to an inflation-based index.[10]

The evidence further shows that several states outside BellSouth's region also have changed their price cap plans to reduce or eliminate productivity factors. For example, Consumer Advocate witness Mr. Buckalew cited Iowa as a state that utilizes price cap regulation with a productivity factor. (Tr. at 191). However, the Iowa Legislature amended its statute, IOWA CODE §476.97, in May 2003 to eliminate the use of productivity factors from price regulation plans. *See* 2003 Ia. Legis. Serv. Ch. 126 (West)(S.F. 368). Additionally, recent updates to price cap plans in Massachusetts, Maine, New Jersey, and Rhode Island have taken the form of eliminating price regulation entirely for the bulk of telecommunications services, leaving restrictions only on basic exchange rates.[11] None of these states currently operate under a price cap plan of the form

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[9] Order, *In Re Order of the Mississippi Public Service Commission Establishing a Docket to Consider Formulating a Properly Structured Price Regulation Plan for South Central Bell*, Docket No. 95-UA-313 (Mississippi Public Service Commission, October 31, 2001).

[10] *See* FLA. STAT. ANN. §364.051(6)(West 2003).

[11] *See* Order, *Investigation by the Department of Telecommunications and Energy on its own Motion into the Appropriate Regulatory Plan to succeed Price Cap Regulation for Verizon New England, Inc. d/b/a Verizon Massachusetts' Intrastate Retail Telecommunications Services in the Commonwealth of Massachusetts*, Docket No. D.T.E. 01-31-Phase II (Massachusetts Department of Telecommunications and Energy, April 11, 2003); Order (Part 2), *Maine Public Utilities Commission Investigation into Verizon Maine's Alternative Form of Regulation*, Docket No. 99-851 (Maine Public Utilities Commission, June 25, 2001); Board Meeting, *In the Matter of the Application of*

recommended by Mr. Buckalew, even for residential basic local exchange services.[12] (Tr. at 804).

3. Market Changes and LEC Line Loss

In our Order, we cite Alltel witness Jane Eve's testimony that market changes such as LEC access line losses have made the productivity factor recommended by the Consumer Advocate obsolete and inappropriate. *See* Order at p. 9. The Consumer Advocate argues that Ms. Eve's testimony "is completely unsupported by any evidence in this record." We disagree. The record is replete with evidence that supports Ms. Eve's statements regarding changes in the market in general and LEC access line losses in particular.

Since the passage of Section 58-9-576(B)(4), for example, both the FCC and this Commission have taken actions (such as implementing the negotiation, unbundling, and resale obligations of the federal Telecommunications Act of 1996) that have "changed dramatically the telecommunications landscape by, among other things, <u>removing entry</u>

Verizon-New Jersey, Inc. for Approval (i) of a New Plan for an Alternative Form of Regulation and (ii) to Reclassify Multi-Line Rate Regulated Business Services as Competitive Services, and Compliance Filing, Docket No. TO01020095 (State of New Jersey Board of Public Utilities, June 19, 2002); Report and Order, *In re: Verizon Rhode Island's Alternative Regulation Plan*, Docket No. 3445 (State of Rhode Island and Providence Plantations Public Utilities Commission, January 10, 2003).

[12] *Id.* The Consumer Advocate states in his Petition that "Dr. Taylor admits that of the states that have undertaken such measures, all have left restrictions in place for basic exchange rates." *See* Petition at p. 5. Dr. Taylor does, in fact, make this statement, (Tr. at 804), but it must be read in context with the very next statement in his testimony – "none of these states currently operate under a price cap plan of the form recommended by Mr. Buckalew, even for residential basic local exchange services." (Tr. at 804). We further note that Section 58-9-576(B)(4) places restrictions on rates for basic services as well – such rates cannot increase at a rate that is more rapid than inflation.

barriers in the local market."[13] The evidence shows that MCI WorldCom -- the only CLEC to participate in this proceeding – had no local exchange customers in South Carolina three years ago. (Tr. at 239). MCI WorldCom has since launched a bundled offering it calls "the Neighborhood,"[14] which an MCI WorldCom officer has described as "the most successful product in the history of consumer local competition." (Tr. at 243-44). Today, MCI WorldCom offers "the Neighborhood" to business and residential customers throughout BellSouth's operating territory in South Carolina. (Tr. at 243).

The evidence further shows that many CLECs are offering vertical services to business and residential customers at competitive prices, (Tr. at 442-45), and CLECs are offering a wide variety of business and residential bundles that include local voice service, vertical features, long distance, broadband service, and more at competitive prices. (Tr. at 458-70). In addition to these traditional landline service offerings, customers in South Carolina can choose from a number of wireless offerings, and at least one company is already offering Internet-based local service to customers in South Carolina. (Tr. at 471-74).

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13 Report and Order, *In the Matter of Policy and Rules Concerning the Interstate, Interexchange Marketplace*, 16 F.C.C.R. 7418 at ¶136 (Rel. March 30, 2001)("Bundling Order") (emphasis added). *See also* Tr. at 441 (BellSouth witness Ruscilli discussed actions taken by the legislature and the Commission to create an environment where competition can flourish).

14 According to an MCI WorldCom mailing, for $55.99 per month the "Neighborhood Complete" offering provides "unlimited local calls, unlimited regional calls, unlimited long distance, call waiting, caller ID, and voicemail." The mailing says that customers also receive "10 FREE movie or game rental certificates good at a participating BLOCKBUSTER store," and that customers will "continue to earn a free rental certificate for every $25 [they] spend each month as a member of The Neighborhood. That's up to 34 free rentals a year!" That is just one "Neighborhood" offering – the mailing says that "the Neighborhood has a range of plans for you to choose from." (Composite Hearing Exhibit No. 4 – JAR-10, Tr. at 582).

Finally, the evidence shows that when BellSouth filed its application to provide interLATA long distance service under Section 271 of the 1996 Act, CLECs had at least 173,995 lines in BellSouth's territory in South Carolina (representing a market share of at least 10.7%) based on March 2002 data. (Tr. at 482; Composite Hearing Exhibit No. 5, Tr. at 642). When this matter went to hearing, CLECs had at least 273,231 lines in BellSouth's territory in South Carolina (representing a market share of at least 16.9%) based on June 2003 data. (*Id*). This represents a 58% increase in overall market share, a 41% increase in business market share, and an 87% increase in residence market share in fifteen months. (Tr. at 482-83).[15] This and other evidence of record clearly supports Ms. Eve's testimony of market changes such as LEC access line losses.[16]

4. Increasing Productivity

The Consumer Advocate argues that Alltel witness Jane Eve "admitted that productivity has increased in the telephone business." *See* Petition at p.4. The fact remains, however, that substantial evidence in the record shows that productivity in the telecommunications business has been declining steadily. Dr. Trimble testified that productivity in the telecommunications industry in general and at Verizon in particular is declining, (Tr. at 308), and Dr. Taylor explained that "forward looking, it's unlikely that [past productivity] growth is going to continue." (Tr. at 818). In fact, Dr. Taylor explained that while productivity was fairly strong in the latter part of the 1990's, local

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15 BellSouth witness Mr. Ruscilli explained that these market share increases figures "are also conservative because they do not include all forms of local service competition, such as wireless competition." (Tr. at 483).

16 In addition to Ms. Eve's testimony at pages 417 and 418 of the transcript, the evidence of declining productivity in the telecommunications industry that we discuss in the following section of this order also supports Ms. Eve's statements.

exchange carriers lost so many lines in 2001 that it "was almost enough to wipe out all growth they had experienced since 1997." (Tr. at 797). He also noted that FCC Chairman Michael Powell recently described capital investment in the telecommunications industry by noting that "Few are prospering. Few are growing. Few are spending. Few are investing. The status quo is certain death and can no longer be considered a viable option." (Tr. at 800). Finally, Dr. Taylor presented evidence demonstrating that capital investment is, in fact, on the decline, which means that "new technology will diffuse more slowly through the telecommunications network, and, all else equal, productivity growth will be slower than it would be if capital spending continued at previous rates." (Tr. at 800).

The Consumer Advocate further argues that a table Dr. Taylor presented in his responsive testimony shows that "telephone company (RBOC) productivity was greater than inflation by 1 to 3 percent. *See* Petition at p. 5, ¶6 (emphasis added). The Consumer Advocate further argues that "BellSouth's own witness confirms the need for a productivity offset to the GDP-PI inflation index adopted by the Commission in this case." *Id*. We disagree. The table referenced by the Consumer Advocate contains data from 1996 through 2001, and in testimony that immediately follows that table, Dr. Taylor states that "the rate of productivity growth . . . has slowed in the current environment, and expectations formed in the mid-1990s regarding real price decreases in the telecommunications industry may no longer be appropriate." (Tr. at 799). As we note in the preceding paragraph of this Order, Dr. Taylor then goes on to testify that past productivity growth is unlikely to continue. Dr. Taylor plainly states that current economic factors do not support use of a productivity factor because

> Competitive forces are sufficient to ensure that prices cannot be held above the competitive market level and thus that productivity gains will be passed through to customers in the form of prices that are lower than they would be had there not been productivity gains.

(Tr. at 801). This evidence, as well the other evidence we discuss in this Order, supports our decision not to use a productivity factor.

5. Recommendation of 2% to 3% productivity factor.

The Consumer Advocate argues that "Mr. Buckalew's recommendation of a productivity factor of 2% to 3% for basic exchange services is the only recommendation in the record and should be adopted by the Commission on reconsideration." *See* Petition at p. 5, ¶7. We disagree. We have carefully considered all of the testimony and evidence again in considering the Consumer Advocate's Petition. For all of the reasons set forth above as well as in our original Order, we find that Section 58-9-575(B)(4) does not require us to use a productivity factor and that economic policy does not necessitate or support the use of such a factor.

6. Selection of GDP-PI as the appropriate measure of inflation.

To the extent that the Consumer Advocate is challenging our selection of the GDP-PI as the appropriate measure of inflation, we reject his challenge. We find that the GDP chain-type index known as the GDP-PI is the best index available for purposes complying with the statute. We base this finding on substantial evidence of record, including without limitation the testimony of Staff Witness Dr. Spearman that is cited at pages 6-7 of our Order, the testimony of Dr. Dennis Trimble that is cited on page 7 of our Order, and the testimony of Dr. William Taylor that is cited at pages 7-8 of our Order.

Additional evidence supporting our finding includes Dr. Taylor's testimony that both practice over time and economic theory support using a rate of inflation that, like the GDP-PI he recommends, "pertains to the general economy, rather than to any specific market, sector, or industry."[17] (Tr. at 739). Dr. Taylor further testified that the GDP-PI in particular has been selected by the FCC as the appropriate measure of inflation to use in relation to telecommunications matters, explaining that:

> Ever since price regulation arrived in the U.S., e.g., with price cap regulation of AT&T in 1989, it has become customary to use the GDP-PI as the measure of general economy-wide inflation in price regulation plans. It has been widely used in the price regulation of ILECs throughout the U.S. From the standpoint of its universal reach as well [as] custom in U.S. telecommunications regulation, the GDP-PI (or Dr. Spearman's choice of the GDP price deflator) is the best choice of an inflation index for price regulation in South Carolina. To the best of my knowledge, the GDP-PI is nearly the universal choice of inflation index for indexed price regulation plans in other states.

(Tr. at 743-44). Similarly, Verizon witness Dr. Trimble explained that in implementing provisions of the federal Telecommunications Act of 1996 that require the FCC to adjust revenue requirements to account for inflation, the FCC decided to use the Gross Domestic Product – Consumer Price Index. (Tr. at 278-79).[18]

Additionally, Dr. Taylor explained that the Gross Domestic Product ("GDP") in

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[17] Dr. Taylor's testimony is supported by the fact that the FCC specifically considered and rejected the use of an industry-specific index, finding that "such an index could be vulnerable to manipulation and would be difficult to develop and implement." Order and Notice of Proposed Rulemaking, *In the Matters of the Implementation of the Telecommunications Act of 1996: Reform of Filing Requirements and Carrier Classifications*, 11 FCC Rec'd 11,716, ¶ 23 (September 12, 1996).

[18] *See* Report and Order, *In the Matters of the Implementation of the Telecommunications Act of 1996: Reform of Filing Requirements and Carrier Classifications*, 12 FCC Rec'd 8071 (May 20, 1997); *see also* Telecommunications Act of 1996, Pub.L. No. 104-104, 110 Stat. 56, §402(c) (1996).

general is more appropriate to use in this context than the other two measures of inflation that Staff witness Dr. James Spearman addresses in his testimony – the Consumer Price Index ("CPI") and the Producer Price Index ("PPI"). (Tr. at 746). Using the GDP, for example, "avoids some of the selectivity problems of the CPI (which does not represent all population groups and fails to account for how consumers alter their consumption of different items when the relative prices of those items change)." (Tr. at 743). Also, the fact that the GDP-PI "is not constrained by the stage of production or consumption" makes it a more appropriate inflation-based index than the PPI, which serves better as a measure of inflation for wholesale goods and services. (Tr. at 743).

Finally, in addition to FCC precedent and sound economic policy, principles of administrative efficiency also support the establishment of the GDP-PI as the inflation-based index under section 58-9-576(B)(4). Dr. Taylor explained that unlike other measures of inflation that were discussed during the hearing, the GDP-PI "is published quarterly and annually by the U.S. Department of Commerce's Bureau of Economic Analysis." (Tr. at 743). Staff witness Dr. Spearman agreed that determining the value of the GDP-PI is simple because these values are available on the Internet. (Tr. at 108). This information will be readily available to consumers as well.

III. CONCLUSION

For the reasons set forth in this Order, the Consumer Advocate's Petition for Rehearing and/or Reconsideration is hereby denied.

IT IS SO ORDERED

BY ORDER OF THE COMMISSION:

/s/
Randy Mitchell, Chairman

ATTEST:

/s/
G. O'Neal Hamilton, Vice Chairman

(SEAL)